

In Illinois, construction contractors are deemed end users of tangible personal property purchased for incorporation into real property. As end users of such tangible personal property, contractors incur Use Tax liability for such purchases based upon the cost price of the tangible personal property. See 86 Ill. Adm. Code 130.1940 and 130.2075. (This is a GIL).

October 13, 1999

Dear Xxxxx:

This letter is in response to your letter dated June 23, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

One of our clients ('Taxpayer') provides the following products or services to customers during the course of the Taxpayer's business operations. The Taxpayer provides interactive security monitoring services from a central location in California via monitoring equipment (consisting of security cameras and audio equipment linked to a computer) at the customer's site. The computer is capable of running sophisticated software designed by the Taxpayer. Information is continually transmitted from the customer's site to the Taxpayer's central monitoring station via phone lines. The products and/or services provided vary, depending on the terms of the contract entered into between the Taxpayer and the customer.

1. Security monitoring services as part of a bundled contract including monitoring equipment (Taxpayer has title), installation and maintenance,
2. Sales of specially configured computers, monitors, audit equipment and security cameras directly to contractors for new installation or capital improvements,
3. Sales of specially configured computers (with proprietary software pre-installed), monitors, audit equipment and security cameras directly to customers,
4. Security monitoring services only (customer has title to all monitoring equipment),
5. Either operating or capital leases of specifically configured computers (with proprietary software pre-installed), monitors,

audit equipment and security cameras directly to customers in combination with security monitoring services,

6. Separately stated installation services provided by the Taxpayer or a subcontractor,
7. Parts used in fulfilling mandatory maintenance agreements sold with the monitoring equipment,
8. Optional maintenance agreements sold separately,
9. Parts used in fulfilling optional maintenance agreements sold separately.

The Taxpayer is planning to expand its operations into your state in the near future. We have been engaged to assist the Taxpayer in determining its tax compliance obligations in your state. Sales/use tax rules can vary dramatically among the states and, due to the complexity of the Taxpayer's operations, we are requesting your assistance to resolve the taxability of various activities, including the specific statutory authority for your opinion.

The Taxpayer pays fees to one or more telephone companies for the use of phone lines for their monitoring services. The Taxpayer does not sell phone lines (or the use of phone lines) to its customers. Based on our research concerning telecommunications services, we do not believe that our client meets the requirements of a telecommunications company. We would like you to confirm that our client would not be treated as a telecommunications company in your state.

To assist you in responding to our request, I have attached a format which includes a listing of the various questions that you need to be answered. The questions were developed from an analysis of the Taxpayer's various types of contracts.

Since time is of the essence, we respectfully request a response at your earliest convenience.

The Retailers' Occupation Tax Act imposes a tax upon persons engaged in the business of selling tangible personal property at retail. A "sale at retail" is any transfer of the ownership of, or title to, tangible personal property to a purchaser, for use or consumption and not for resale in any form as tangible personal property, for a valuable consideration. See the enclosed copies of 86 Ill. Adm. Code 130.101 and 130.201. Canned computer software is considered tangible personal property subject to tax. See, 86 Ill. Adm. Code 130.1935, enclosed.

In order to incur Illinois sales tax liability, there must be a sale of tangible personal property. When vendors provide security systems and monitoring

services without transferring any tangible personal property, no Retailers' Occupation Tax is due on the transaction. However, vendors who use tangible personal property in Illinois in providing security systems and monitoring services owe Use Tax on the cost price of the tangible personal property they use.

With regard to items transferred to customers, the type of tax will depend upon whether or not these items are permanently affixed to realty. If vendors permanently affix tangible personal property to a structure so as to constitute real estate the vendors would owe Use Tax based upon their cost price of the additions. This is because Illinois law deems persons who take tangible personal property and convert it into real estate to be construction contractors who are the legal end-users of the property.

Please find enclosed copies of 86 Ill. Adm. Code 130.1940 and 130.2075 regarding the tax liabilities of contractors in Illinois. The term "construction contractors" includes general contractors, subcontractors, and specialized contractors such as landscape contractors. The term "contractor" means any person or persons who are engaged in the occupation of entering into and performing construction contracts for owners. In Illinois, construction contractors are deemed end users of tangible personal property purchased for incorporation into real property. As end users of such tangible personal property, contractors incur Use Tax liability for such purchases based upon the cost price of the tangible personal property. Therefore, any tangible personal property that general contractors or subcontractors purchase that will be permanently affixed to or incorporated into real property in this State will be subject to Use Tax. If contractors did not pay the Use Tax liability to their suppliers, contractors must self-assess their Use Tax liability and pay it directly to the Department.

Contractors incur Retailers' Occupation Tax upon the sale of items that are not permanently affixed to real estate. However, please note that Section 1 of the Retailers' Occupation Tax Act states that "[c]onstruction contracts for the improvement of real estate consisting of video, security, and all telecommunication systems do not constitute engaging in a business of selling tangible personal property at retail within the meaning of this Act if they are sold at one specified contract price". Consequently, even if some items used in such contracts are not permanently affixed, the liability incurred by the contractor is a Use Tax liability if the provisions of this section are met.

When contractors perform service or repair work on items that are permanently affixed to real estate, the Department considers these to be construction contract situations and contractors incur Use Tax and local Retailers' Occupation Tax reimbursement liabilities on cost prices of supplies and repair parts permanently affixed to realty. They should pay tax to their Illinois registered suppliers on materials they will incorporate into real estate. If such materials are purchased without paying tax, such as from unregistered out-of-State suppliers, the purchasing contractors must self-assess and pay the Use Tax directly to this Department. Please note that the Illinois Use Tax provides a credit for taxes paid to other states under certain

circumstances. See the enclosed copy of 86 Ill. Adm. Code 150.310 concerning Exemptions to Avoid Multi-State Taxation.

When service or repair work is performed on items that are not permanently affixed to real estate, any tangible personal property transferred incident to those sales of service are subject to Service Occupation Tax liability. For your general information we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen choose to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under the Retailers' Occupation Tax Act.

The taxability of maintenance agreements is dependent upon whether the charge for the agreement is included in the selling price of tangible personal property. If the charge for a maintenance agreement is included in the selling price of tangible personal property, that charge is part of the gross receipts of the retail transaction and is subject to Retailers' Occupation Tax liability. No tax is incurred on the maintenance services or parts when the repair or servicing is completed.

If maintenance agreements are sold separately from tangible personal property, the sale of the agreement is not a taxable transaction. However, when maintenance services or parts are provided under the maintenance agreement, the company providing the maintenance or repair will be acting as a service provider under the Service Occupation Tax Act. The Service Occupation Tax Act provides that when a service provider enters into an agreement to provide maintenance services for a particular piece of equipment for a stated period of time at a predetermined fee, the service provider incurs Use Tax based upon its cost price of tangible personal property transferred to the customer incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3), enclosed.

The provision of security services may be subject to the Telecommunications Excise Tax. See 35 ILCS 630/1 et seq. The Telecommunications Excise Tax is imposed upon the act or privilege of originating or receiving intrastate or interstate telecommunications in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers. See 86 Ill. Adm. Code 495, enclosed.

Pursuant to Section 495.100(a), "gross charge" means the amount paid for the act or privilege of originating or receiving telecommunications in this State and for all services and equipment provided in connection therewith by a retailer, valued in money, whether paid in money or otherwise, including cash credits,

services and property of every kind or nature, and shall be determined without any deduction on account of the cost of such telecommunications, the cost of material used, labor or service cost or any other expense whatsoever.

Please note that the State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See the enclosed copy of 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See 86 Ill. Adm. Code 150.310(a)(3) enclosed.

Under Illinois law, lessors may not "pass through" their tax obligation on to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

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If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis  
Associate Counsel

MAJ:msk  
Enc.